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No. 71-1130

In the Supreme Court of the United States

OCTOBER TERM, 1971

CARGILL, INCORPORATED, ET AL., PETITIONERS

v.

EARL F. BUTZ, SECRETARY OF AGRICULTURE, ET AL.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE EIGHTH CIRCUIT

BRIEF FOR THE RESPONDENTS IN OPPOSITION

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OPINIONS BELOW

The opinion of the court of appeals (Pet. App. A, pp. 1–39) is reported at 452 F. 2d 1154. The opinion of the Judicial Officer of the United States Department of Agriculture appears at 29 A.D. 880 (CEA 1970).

JURISDICTION

The judgment of the court of appeals was entered on December 7, 1971. The petition for a writ of certiorari was filed on March 6, 1972. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

QUESTIONS PRESENTED

1. Whether the evidence supports the finding of the Secretary of Agriculture that the petitioners manip-

ulated the market price of May 1963 wheat futures, in violation of Section 6(b) of the Commodity Exchange Act (7 U.S.C. 9), by extracting artificial prices in the sale of their futures contracts.

2. Whether "squeezes," intentionally brought about, are a form of manipulation prohibted by Section 6(b) of the Act.

STATEMENT

A hearing examiner of the Department of Agriculture found that petitioners Cargill, Inc., a corporation engaged in the grain merchandising and export business, and four of its officers, had manipulated the price of May 1963 wheat futures on the Chicago Board of Trade on May 21, 1963, and the price of cash wheat in Chicago on May 20 and 21, 1963, in willful violation of Sections 6(b) and 9 of the Commodity Exchange Act (7 U.S.C. 9, 13). He proposed an order suspending the registration of Cargill as a futures commission merchant under the Act for 90 days and an order to the contract markets to refuse all trading privileges to all petitioners for 90 days. Upon a *de novo* review of the record, the Judicial Officer of the Department of Agriculture affirmed the hearing examiner's decision in all material respects, but suspended the proposed sanctions (A. 77).

1. THE COMMODITY EXCHANGE ACT

Commodity exchanges are markets where the right to receive or the right to deliver goods such as grain during a specified future month are bought and sold. When a person buys futures he becomes obligated to take delivery of the commodity or make an offsetting

sale and is referred to as a "long" (Pet. App. A-3). When a person sells futures he becomes obligated to deliver or make an offsetting purchase and is referred to as a "short" (*ibid.*).

As set forth in the Commodity Exchange Act, 7 U.S.C. 1–17b,[1] Congress found that with respect to futures trading in wheat and other designated agricultural commodities, transactions and prices "are susceptible to speculation, manipulation, and control," which frequently give rise to "sudden or unreasonable fluctuations." Since this would be detrimental to producers, consumers and handlers of these commodities,[2] Congress found it necessary to regulate the commodity exchanges.

The Act thus provides that all trading in futures in the specified commodities must be conducted on designated boards of trade regulated by the Secretary of Agriculture. 7 U.S.C. 2, 6. Manipulation or attempted manipulation of the market price of any commodity in interstate commerce or for future delivery on or subject to the rules of any board of trade is a violation of the Act. 7 U.S.C. 9, 13. The Secretary is empowered to issue complaints against persons he believes to have violated the Act and if, after a hearing, a violation is found the Secretary may impose sanctions, including suspension of trading privileges. 7 U.S.C. 6g, 9. The Secretary's order is reviewable in

[1] The Act is derived from the Grain Futures Act of 1922, 42 Stat. 998. See Campbell, *Trading in Futures Under the Commodity Exchange Act*, 26 Geo. Wash. L. Rev. 215 (1958), discussing the background, legislative history and purposes of the Act.

[2] *See Chicago Board of Trade* v. *Olsen*, 262 U.S. 1, 39.

the courts of appeals, but his findings of fact "if supported by the weight of the evidence, shall * * * be conclusive." 7 U.S.C. 9.

2. CARGILL'S TRADING IN MAY 1963 WHEAT FUTURES

Between April 15, 1963, and May 15, 1963, Cargill increased its speculative[*] long position in May 1963 wheat futures from 250,000 bushels to 1,930,000 bushels (Pet. App. 8). In early April, shortly before it began buying these futures, only Cargill knew that it owned nearly 90 per cent of the deliverable wheat stored in Chicago warehouses (Pet. App. 9). By May 20, 1963, Cargill had sold to Spain or otherwise committed all but 50,000 bushels of wheat in its Chicago warehouses, which constituted all of the wheat in Chicago deliverable on May 1963 wheat futures (Pet. App. 9–10).

May 21, 1963, was the last day on which May 1963 wheat futures could be traded on the Chicago Board of Trade and, under the Board's rules, price fluctuations were limited to 10 cents above or below the closing price on the previous day, which was $2.18⅝ per bushel, an increase of 9¾ cents over the closing price of the day before. Acting on Cargill's instructions to sell on an ascending scale of prices, Cargill's broker began liquidating Cargill's holdings on May 21 at

[*] Cargill's position was speculative because it had "ample supplies of uncommitted wheat stocks" and was not buying futures to insure sufficient supplies to meet delivery obligations (Pet. App. 8 n. 4).

11:53 a.m., seven minutes before closing. At this time Cargill had 62 per cent of the open interest in May 1963 wheat futures. By closing time at 12:00 p.m., the price of these futures had reached the maximum of $2.28⅝ and Cargill had managed to liquidate 1,625,000 of the 1,990,000 bushels it held in those futures.[4] (Pet. App. 10–11).

Cargill later sold warehouse receipts at $2.28¼ per bushel, and these were in turn tendered to Cargill in satisfaction of the delivery obligation of the shorts "who were unable to get out of the market in the closing rush" (Pet. App. 13).

3. DECISIONS OF THE HEARING EXAMINER AND JUDICIAL OFFICER

The Secretary's complaint charged Cargill and four of its officers with manipulating the market price of May 1963 wheat futures by means of a "little corner" or "squeeze." A "squeeze" can occur when deliverable supplies of a commodity in the delivery month are low, and the open interest on the futures market is considerably in excess of the deliverable supplies (Pet. App. 15). Then most of the shorts cannot satisfy their contracts by delivery and must therefore bid against

[4] Because of confusion in the pits, Cargill's broker could not execute the remainder of its order, thus leaving Cargill with 365,000 bushels in the May future (Pet. App. 11).

[5] See note 4 *supra*.

each other in order to offset their contracts, thus driving up the price of the future (*ibid.*).[6]

In this case the complaint alleged that "(1) Cargill acquired and held a controlling long position in the May 1963 wheat futures; (2) there was an insufficient supply of wheat available to the shorts for delivery on the futures, and what supply there was was controlled by Cargill; (3) Cargill exacted an artificially high price in liquidation of its futures contracts; and (4) the squeeze was intentionally caused by Cargill" (Pet. App. 15).

Cargill challenged the factual bases of each of the above elements of the complaint, and, in addition, argued that squeezes are not a form of manipulation prohibited by the Act (Pet. App. 16).

The hearing examiner found that the evidence supported the Secretary's complaint on each of the above points, and rejected Cargill's other defenses. Upon a *de novo* review, the Judicial Officer affirmed the findings of the hearing examiner (A. 31–78), concluding that Cargill had acted with manipulative intent, that

[6] A "corner" designates the situation where a trader buys up enough of the commodity in the cash market to dry up the supplies available for delivery and, at the same time, fails to offset his long position during the last days of trading in the futures. See, *e.g.*, *Great Western Food Distributors, Inc.* v. *Brannan*, 201 F. 2d 476 (C.A. 7), certiorari denied, 345 U.S. 997. A "squeeze" differs from a "corner" in that the trader dominates only the futures market by owning long futures contracts considerably in excess of the deliverable amount of the commodity, which may be in low supply for reasons other than the trader's monopoly of the cash market. (Pet. App. 14–15).

[7] "A." refers to the Appendix in the court of appeals.

is, "it intentionally undertook to influence the May futures price and cash price upward" (A. 70).[5]

With respect to Cargill's defense that there were deliverable supplies of wheat available, which the shorts could have delivered on their contracts under the Board of Trade's rule permitting delivery for 7 days after the end of trading, the Judicial Officer found that (A. 72):

> Outside of soft red wheat being utilized by mills in Chicago, there was practically no available deliverable wheat in Chicago except that held by Cargill.
>
> As far as soft red winter wheat outside Chicago is concerned, if there were supplies which could be economically deliverable by the shorts after May 21, it would hardly be necessary for the Chicago Board of Trade to come to Cargill after the end of trading and participate in the arrangement of dubious validity described in Finding of Fact 30 [the delivery and re-delivery of Cargill's own warehouse receipts to the unresolved shorts].

Thus, "there were time and economic impediments to

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[5] The Judicial Officer summarized his findings on this point as follows (A. 70):

"The next question for consideration is whether Cargill's activities described above were done with manipulative intent, that is, with intent to influence prices upward. Of course Cargill was not long because it wanted delivery of wheat upon its long contracts, or because it was hedging. Its long position was a speculative one and, at the least, it hoped or expected that the May futures price would go up. But we think that the preponderance of the evidence reveals that Cargill was not content merely with hopes and expectations and that it intentionally undertook to influence the May futures price and cash price upward."

the importing of wheat into Chicago by shorts for delivery within the seven days allowed."[9] The shorts instead preferred to pay the illegal premiums charged by Cargill, since this was less risky and less expensive (A. 73).

4. THE COURT OF APPEALS DECISION.

In a comprehensive opinion, the court of appeals affirmed (Pet. App. 1–39). After reviewing the evidence and the findings of the Judicial Officer, the court concluded that the "finding that the futures price was artificially high and did not reflect basic supply and demand factors for cash wheat is supported by the weight of the evidence" (Pet. App. 30).

The court also held that a "squeeze" was a form of manipulation prohibited by the Act. "[T]he test of manipulation must largely be a practical one if the purposes of the Commodity Exchange Act are to be accomplished" and the "aim must be therefore to discover whether conduct has been intentionally engaged in which has resulted in a price which does not reflect basic forces of supply and demand" (Pet. App. 17). Reviewing the legislative history of the Act, the court found that "squeezes were intended to be prohibited where they were intentionally manipulated" (Pet. App. 14).

Cargill argued that squeezes should not be illegal because this would relieve shorts of their obligation

[9] A principal reason for the shortage of available wheat in the Chicago area was that Cargill had been selling abroad substantial quantities of wheat it owned, while building up its long futures position (Pet. App. 9–10).

to deliver. But the court rejected this contention because a futures market is not an alternative spot market and if futures trading is to perform its function of stabilizing commodity prices, both longs and shorts must be "assured that they can offset their contracts at non-manipulated prices" (Pet. App. 37). A squeeze dislocates both the cash and futures markets and it would serve no useful purpose to encourage activity such as Cargill's (Pet. App. 37–38).

ARGUMENT

The decision below is correct, and there is no reason for review by this Court.

1. In large measure, petitioners' contentions are based on disagreement with factual findings of the Judicial Officer. Thus petitioners argue that the Judicial Officer erred in his findings that Cargill had the requisite intent (Pet. 6–9), that other wheat was not available to the "shorts" (Pet. 7), and that the price of wheat futures at the end of trading in May 1963 futures was artificial and did not represent real economic values (Pet. 11). On the basis of its own review of the evidence, the court below properly sustained these findings as supported by the weight of the evidence (Pet. App. 30).

The facts here, as found by the Judicial Officer (A. 67–68), show one of the most obvious forms of manipulation—indeed, one described in the legislative history of the Act as the kind of transaction Congress sought to prevent. See 80 Cong. Rec. 8089. As the court of appeals stated, the "extraordinary price fluctuations of the futures market on May 20 and 21,

1963, in the Chicago Board of Trade were the largest in recent history and had very little relationship to basic supply and demand factors on No. 2 soft red winter wheat. None of the other markets was so affected" (Pet. App. 34). But "the only reason the price advanced so rapidly during the last few minutes of trading was because of Cargill's dominance of the long interest and the high prices it set for liquidation" (Pet. App. 31). As compared with the activity of other experienced grain merchandisers on May 20 and 21, "Cargill's method of liquidation cannot be considered to be ordinary market behavior" (Pet. App. 32). "Its behavior in liquidating its contracts was clearly intentional and was highly unusual market behavior; and the method of liquidating the unresolved open interest following the close of trading was also unusual and clearly controlled by Cargill" (Pet. App. 33).

As the court of appeals stated (Pet. App. 34–35), Cargill did not want delivery and held out only to drive the price up to an artificial peak:

> It is inconceivable that Cargill would want to take 2,000,000 bushels of old crop wheat to try to merchandise before the new crop came in. In fact Cargill's officers themselves testified that Cargill was liquidating its stocks "to the zero point."
>
> * * * * *
>
> The long futures holders were not standing for delivery but for the maximum possible price, which Cargill was able to obtain to a substantial degree by bulling the futures market in the

> last 7 minutes of trading and in employing the method of liquidation utilized after the trading closed. Cargill did not sell at the market price but set the market price by reason of its dominant long position in the closing 7 minutes.
>
> * * * * *
>
> The conclusion is well founded that these severe fluctuations were caused by Cargill's manipulative actions and such severe fluctuations constitute a threat to a free and orderly market. * * *

2. The court of appeals fully answered Cargill's argument that the Secretary's decision leaves the longs at the mercy of the shorts in local shortage situations, and will succeed only in eventually destroying futures markets (Pet. App. 38):

> The first answer to this argument is that it is difficult to imagine a local shortage situation in which the long is at the mercy of the short. Cargill was certainly not at the mercy of the shorts in May 1963 and would not have been had it even liquidated its holdings in an orderly fashion. And had it so liquidated its holdings; it would still have made a handsome profit on its investment, even without the added increment which its manipulation produced. The second answer is that we have been shown no good reason why the futures price should reflect the cost of bringing in a higher price and grade of wheat for which there is no demand in the local area. It is this price which was artificially high and therefore useless to the trade and nation.

As the court also pointed out, "[w]hile the obligation to make or take delivery is a bona fide feature of the futures contract, in reality the futures market is not an alternative spot market for the commodity itself, and indeed the functions performed by the futures market would probably be severely hampered if it were turned into an alternative spot market" (Pet. App. 37). If in a squeeze situation, the shorts are forced either to pay manipulated prices to offset their contracts or to bring in higher priced outside supplies that are neither wanted nor needed in the local market, then both the cash and the futures markets will be dislocated.

The sharp contrast between the activities of others in a long position and those of Cargill further supports the conclusion that Cargill manipulated the market price. While others were liquidating their long positions in an orderly way, Cargill was increasing its long position in order to gain an inordinate advantage over the shorts at the last minute because of the lack of deliverable wheat—a condition to which Cargil had substantially contributed (see n. 9 *supra*.).

The prices Cargill demanded and received for its futures and its warehouse receipts were not sufficiently high to force the shorts to bring in wheat from Kansas City, St. Louis, Fort Worth, or other locations, but this does not itself disprove the artificiality of the prices Cargill established. The fact that outside supplies exist "means that there is merely a ceiling placed on the extent of manipulation possible. The availability of such supplies does not negate the exist-

ence of a manipulation." *In re G. H. Miller & Company, et al.*, 15 A.D. 1015, 1046, affirmed, *G. H. Miller & Company* v. *United States*, 260 F. 2d 286 (C.A. 7), certiorari denied, 359 U.S. 907. See also *In re Great Western Distributors, Inc.*, 10 A.D. 783, 809, affirmed, *Great Western Food Distributors, Inc.* v. *Brannan*, 201 F. 2d 476, 480–481 (C.A. 7), certiorari denied, 345 U.S. 997. The shorts had to choose between paying Cargill's liquidating prices or paying someone else more. They understandably chose the former course. The fact that the latter course was open to them does not show that Cargill's prices were justified. The position in which the shorts found themselves is precisely the situation a manipulator seeks to bring about.

3. Petitioner contends that there is a conflict between the decision below and *Volkart Brothers, Inc.* v. *Freeman*, 311 F. 2d 52 (C.A. 5). As the court below pointed out, however, there are essential differences between the situation here and the situation in *Volkart*:

> For example, Volkart contended that its position was a hedge, not speculative. Furthermore, Volkart did not control a significant amount of the spot commodity and had not contributed to its shortage, whereas Cargill controlled almost all the available cash wheat and was responsible in large part for the existing shortage by its Spanish sales. Finally, the Fifth Circuit found no evidence of intent to manipulate on the part of Volkart.

(Pet. App. 36, n. 15). Furthermore, unlike Volkart, petitioner possessed valuable information unknown

to other traders, namely, that it owned practically all the wheat available for delivery on the May future (Pet. App. 9).

Although *Volkart* held that squeezes "not planned or intentionally brought about" are not prohibited by the Act, 311 F. 2d at 58–59, the court ended its lengthy opinion in that case with the following statement, which petitioners interpret as meaning that even intentional squeezes may not be prohibited: "For the respondents to proceed upon the assumption that the shorts should not be required to deliver at maturity would be to put them in the position of regulating a gambling institution rather than a legitimate futures exchange." *Id.* at 60. But whatever this somewhat oblique passage may suggest about the Fifth Circuit's views on the issue, it is not an actual decision on the point, and does not establish that the Fifth Circuit would have decided the present case contrary to the way the Eighth Circuit did. An approach to the problems of manipulation in the commodities market as unduly restrictive as petitioners propose should not be imputed to the Fifth Circuit, particularly in view of the fact that other courts have rejected such an approach, see *Great Western Food Distributors* v. *Brannan*, 201 F. 2d 476, 481 (C.A. 7), certiorari denied, 345 U.S. 997; *G. H. Miller & Co.* v. *United States*, 260 F. 2d 286, 289 (C.A. 7), certiorari denied, 359 U.S. 907, as did the court of appeals in this case.[10]

[10] See also *Chicago Board of Trade* v. *Olsen*, 262 U.S. 1, 39, where this Court noted that "[m]anipulations of grain futures

The economic unsoundness of immunizing manipulative squeezes from the Act's prohibitions and the reasons why Congress could not have intended such a result are fully set forth in the opinion below (Pet. 37–39). In any event, there is no direct conflict here, and thus no occasion to review this essentially factual case.[11]

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for speculative profit, though not carried to the extent of a corner or complete monopoly, exert a vicious influence and produce abnormal and disturbing temporary fluctuations of prices that are not responsive to the actual supply and demand and discourage not only this justifiable hedging but disturb the normal flow of actual consignments. A futures market lends itself to such manipulation much more readily than a cash market."

[11] There is no merit to petitioners' contention that the court's decision here conflicts with *Board of Trade of the City of Chicago* v. *Christie Grain & Stock Co.*, 198 U.S. 236 (Pet. 10–12). The decision below is fully in accord with this Court's statement there that "[t]he sales in the pits [futures contracts] are not pretended, but, as we have said, are meant and supposed to be binding." 198 U.S. at 249–250. This court also pointed out in that case (198 U.S. at 248):

"* * * The fact that contracts are satisfied * * * by set-off and the payment of differences detracts in no degree from the good faith of the parties, and if the parties know when they make such contracts that they are very likely to have a chance to satisfy them in that way and intend to make use of it, that fact is perfectly consistent with a serious business purpose and an intent that the contract shall mean what it says. * * *"

Christie Grain does not suggest that because shorts have a binding legal obligation, they must anticipate, and have no recourse against, deliberate manipulations that render it more difficult for them to satisfy their legal obligations.

CONCLUSION

For the reasons stated, the petition for a writ of certiorari should be denied.

Respectfully submitted.

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